

**Most Security Controls Were Adequate at the  
New Lockbox Facility in Dallas, but Some  
Improvements Are Needed**

**July 2002**

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DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

July 5, 2002

MEMORANDUM FOR COMMISSIONER ROSSOTTI

*Scott E. Wilson*

FROM: (for) Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Most Security Controls Were Adequate at the New Lockbox Facility in Dallas, but Some Improvements Are Needed (Audit # 200230016)

This report presents the results of our review of security at the Internal Revenue Service's (IRS) lockbox facility in Dallas, Texas. The overall objectives of this review were to:

- Evaluate the physical and internal controls of the new lockbox facility to determine whether taxpayer remittances were adequately safeguarded and taxpayer information was protected from unauthorized disclosure.
- Determine whether the facility provided for employee safety and ensured that operations would continue in the event of a disaster or receipt of hazardous material in the mail.

The IRS lockbox program consists of commercial banks that have contracted with the Financial Management Service (FMS) to process tax payments. This program was designed to accelerate the deposit of tax payments by having taxpayers send their payments to commercial banks rather than to the IRS.

With this acceleration can come significant risks, however, as was evidenced during 2001 when control weaknesses contributed to the loss of taxpayer payments and taxpayer information at a lockbox bank in Pittsburgh, Pennsylvania. Approximately 71,000 taxpayer remittances valued in excess of \$1.2 billion were lost or destroyed.

The Dallas lockbox facility began receiving tax payments in December 2001. The bank receives payments for U.S. Individual Income Tax Returns (Form 1040 series), employment tax returns (Form 940 series), and other miscellaneous types of taxes. In

Calendar Year (CY) 2001, lockbox banks processed more than 72 million payments totaling over \$329 billion. Lockbox banks processing payments for the Ogden and Austin Submission Processing Centers received approximately 21.5 percent of the total dollars processed by lockbox banks in 2001.

In summary, we found the lockbox facility in Dallas was in compliance with most of the security requirements in the Lockbox Processing Guidelines for 2002. However, improvements were needed in security for courier services, packaging of remittances, adherence to candling<sup>1</sup> requirements, documentation of personnel files, and destruction of sensitive taxpayer information. We made specific recommendations to improve controls in each of these areas.

Management's response was due on June 27, 2002. As of July 3, 2002, management had not responded to the draft report.

Issues regarding the adequacy of the Lockbox Processing Guidelines themselves are not included in this report. These issues will be addressed in a separate report covering all three lockbox operations recently reviewed.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions, or your staff may call Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

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<sup>1</sup> Candling is the process of using light to determine if any contents remain in envelopes.

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### **Background**

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The Internal Revenue Service (IRS) lockbox program consists of commercial banks that have contracted with the Financial Management Service (FMS) to process tax payments.<sup>1</sup> This program was designed to accelerate the deposit of tax payments by having taxpayers send their payments to commercial banks rather than to the IRS. There are 9 lockbox sites nationwide that support the 10 IRS Submission Processing Centers. The lockbox sites augment the 10 Submission Processing Centers' remittance processing capabilities, and were contracted to help the IRS optimize deposits to the Treasury and increase interest savings.

Bank of America operates the Dallas, Texas, lockbox facility that processes business tax payments for the Ogden Submission Processing Center and individual tax payments for the Austin Submission Processing Center. This is the first year of operation for the Dallas facility, which began receiving and processing payments in December 2001. The lockbox receives payments for U.S. Individual Income Tax Returns (Form 1040 series), employment tax returns (Form 940 series), and other miscellaneous types of taxes. In Calendar Year (CY) 2001, lockbox banks processed more than 72 million payments totaling over \$329 billion. Lockbox banks processing payments for the Ogden and Austin Submission Processing Centers received approximately 21.5 percent of the total dollars processed by lockbox banks in 2001.

The protection of both remittances and the associated taxpayer information is a unique requirement for these processing sites. Secure facilities and systems are required, as well as background investigations on the large numbers of temporary employees required to handle the four annual peak periods when the tax payments are due.

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<sup>1</sup> Pursuant to 31 U.S.C. 3720(a), executive agencies of the Government are required to provide for the collection and timely deposit of funds by the use of mechanisms and procedures, which may include lockbox collection services. The FMS has authority to specify use of particular methods and mechanisms for the collection and deposit of executive agency funds, including tax collections (31 C.F.R. Part 206).

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The Lockbox Processing Guidelines represent the agreement among the IRS, the FMS, and the banks detailing the specific services that the banks will perform for the IRS. These services include tasks that the IRS would otherwise have to do, such as ensuring checks are properly endorsed and deposited, providing security over the remittances and taxpayer data, and creating computer tapes of payment transactions. The lockbox also receives, sorts, and ships tax returns to the IRS. The IRS and the FMS are responsible for providing oversight of lockbox activities to ensure that the banks adhere to the requirements in the Guidelines.

While the lockbox system is intended to provide the government with efficient cash management, there have been instances of fraud, waste, and abuse that demonstrated a need for increased controls. In 1998, over 400 checks were discovered in a night shift manager's desk drawer at a lockbox bank in Charlotte, North Carolina. In 2001, control weaknesses contributed to the loss of taxpayer payments and taxpayer information at a lockbox bank in Pittsburgh, Pennsylvania. Approximately 71,000 remittances valued in excess of \$1.2 billion were lost or destroyed.

We conducted audit work at the Dallas lockbox facility and the Ogden Submission Processing Center from January through April 2002. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objectives, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

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### **The Dallas Lockbox Facility Met Most Physical and Data Security Guidelines**

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The Dallas lockbox facility was in compliance with most of the 2002 Lockbox Processing Guidelines concerning physical and data security.

#### **Employee background screening for personnel security met processing guidelines**

The required Federal Bureau of Investigation (FBI) fingerprint check was completed prior to the date of access to the lockbox for each individual included in our judgmental sample of bank employees, temporary employees, and vendors working in the lockbox processing area.

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### **Most courier requirements were met**

Couriers were insured for \$1 million,<sup>2</sup> and emergency contact information was provided to lockbox management as required. The courier services' disaster contingency plan covered all significant required situations.

Couriers displayed identification cards, documented pick-ups and deliveries in appropriate logs, were equipped with communication equipment, traveled in pairs, and transported packages to the final destination without intermediary stops in vehicles that met processing guideline requirements.

### **Overall, adequate physical security responsibilities and controls had been established**

Security reviews performed by the IRS and the FMS showed the lockbox bank's readiness to begin processing. Proper corrective actions were taken on security breaches and control weaknesses identified by the IRS and the FMS.

The intrusion detection system, duress alarms, automated entry system, perimeter security, and surveillance equipment all complied with processing guideline requirements.

Entry into the lockbox processing area was limited to authorized personnel displaying proper identification badges. Lockers were provided outside of the controlled working areas, and personal items were not allowed in the processing area.

The required guards were on duty. The guard service provided for sign-in/sign-out control for all visitors, inspection of all packages and mail deliveries, monitoring of courier deliveries, and escort of mail-out packages for courier pick-up.

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<sup>2</sup> Some of the coverages were due to expire soon after our visit. We discussed the issue with the lockbox coordinator, who assured us she would follow up to ensure the coverages were not allowed to lapse.

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### **Overall, adequate data security responsibilities and controls had been established**

Currency, keys, key cards, and date stamps<sup>3</sup> were properly controlled and stored in containers to deter theft and fraud, as required. Lockbox management was performing required searches for unprocessed remittances and tax returns and properly maintaining a log identifying the desk reviews performed. Further, remittances were properly stamped with “United States Treasury” or other acceptable payee designations in the payee section.

Lockbox employees certified that they understood disclosure restrictions and security procedures prior to accessing tax information by signing disclosure statements and attending security awareness training.

### **Controls were in place to provide for employees’ safety and to ensure that operations continued in the event of a disaster or receipt of hazardous or life-threatening material in the mail**

Lockbox management had properly briefed employees who handled the incoming mail regarding safety procedures, including the identification of suspicious letters and packages. The instructions were current and adequate to protect employees in case of an accident or receipt of contaminated mail. The safety procedures, along with emergency contact numbers, were posted in the mail receipt area.

The mail was received and opened at one central location. All mail receipts were routed through the United States (U.S.) Post Office. Facilities for potentially exposed employees to wash were within a reasonable distance of the mail area.

Lockbox management had developed an occupant emergency plan that conformed to processing guideline requirements. Lockbox management had also established a

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<sup>3</sup> Date stamps were stored in lockable containers; however, we observed instances when these containers were not locked. Lockbox management informed us they would immediately begin locking these containers at all times.



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### **Several Control Weaknesses Need Attention to Reduce the Risks Associated With Processing Taxpayer Payments and Taxpayer Information**

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business continuity/ contingency plan to ensure that mail and normal work operations continued in the event of a disaster or receipt of life-threatening material through the mail.

Additional controls or actions need to be implemented to reduce the risks associated with processing large volumes of taxpayer remittances that could lead to financial losses and disclosure of sensitive tax information.

#### **Controls need strengthening to ensure that only authorized courier employees have access to taxpayer remittances and sensitive taxpayer information**

The lockbox facility uses two courier services as well as an air transport company to transport remittances and tax returns among the U.S. Post Office, the lockbox processing facility, the depository bank, and the IRS Submission Processing Center. We found the following weaknesses in controls related to courier services.

- **Couriers were granted access to IRS materials prior to the lockbox receiving results of their FBI fingerprint checks.**

Three couriers were allowed access to the lockbox and taxpayer information prior to the receipt of the results of their FBI fingerprint checks, because lockbox management did not develop and implement procedures to ensure proper clearance had been granted prior to couriers receiving IRS data. Two of these couriers actually had questionable results when the FBI fingerprint checks were completed. The questionable items were ultimately resolved, and the couriers were approved for access to the lockbox.

An FBI fingerprint check must be performed for each individual who will have access to the lockbox processing area or taxpayer information. The results of the fingerprint check must be obtained prior to the date on which an individual is granted access to IRS data.

- **Couriers with questionable FBI fingerprint results continued to receive access to the lockbox.**

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Fingerprint checks for three couriers with access to the lockbox indicated the couriers had some criminal history. All three of these couriers were approved for access to the lockbox based on the investigation of a local security company, as verified by the National Background Investigation Center (NBIC). However, the reliability of the local investigation is questionable because only one week prior to receiving the FBI fingerprint check indicating a criminal history for one courier, the security company issued a letter to the courier stating there was “no indication of Texas criminal history or nationwide warrants for arrest as of this date.” The courier provided a copy of the letter to the lockbox bank. In reality, this courier had two arrests in Texas. More significant, two of these couriers were allowed access to the lockbox between the dates that the FBI fingerprint check indicated a criminal history, and the dates that the IRS approved the couriers based on the follow-up performed by the local security company and the NBIC.

The guidelines and letters provided to the lockbox bank state that if FBI fingerprint checks indicate a potential criminal history, further investigation will be required by the NBIC before a determination can be made regarding an individual’s access to the IRS lockbox facility. They further state that all FBI “hits” must be resolved before an individual is allowed access to the lockbox site. Lockbox management had not developed and implemented procedures to ensure that couriers with questionable fingerprint results were restricted from access to lockbox data until all questionable items were resolved.

- **One courier service did not provide lists of authorized courier employees or notify the lockbox within 24 hours, via facsimile transmission, when an employee was hired or discharged from his/her duties.**

Lockbox personnel talked with the courier service frequently, and learned about staff changes in these informal conversations. However, courier services are

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required to notify the lockbox within 24 hours, via facsimile transmission, when an employee assigned is discharged or when a new employee is hired. Lockbox management did not require the courier service to provide the required documentation for staff changes.

- **Couriers for one company did not wear company logo uniforms that allow for proper identification.**

The Lockbox Processing Guidelines require that courier service employees wear a company logo uniform. However, these courier drivers dealt specifically with personnel from the IRS and the air transport service, but not with lockbox personnel, so lockbox management was not aware that the couriers did not wear appropriate uniforms.

- **Shipments of tax returns and remittances from the lockbox bank to the Submission Processing Center were left unsecured by the air transport company.**

We observed a shipment of tax returns and unprocessed remittances left unattended on a loading dock at the air transport company. The tax data was accessible to employees of the air transport service as well as anyone accessing the loading dock.

The processing guidelines do not give specific instructions regarding air transport services. However, in our view the same controls and precautions to prevent disclosure and theft of taxpayer remittances and tax data employed by ground courier services and lockbox facilities should apply to shipments sent by air transport.

Reviews conducted by the IRS and the FMS did not address courier controls. The weaknesses discussed above increase the risk of disclosure of sensitive taxpayer data and theft of remittances.

### **Remittances were not properly packaged for transport**

Remittances were not placed in secured sleeves or locking containers that provided proper protection and met the minimum processing guidelines shipping requirements. The remittances, which included those processed by the lockbox bank and ready for deposit, as well as those being shipped to

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the Submission Processing Center for processing, were instead placed in cardboard boxes that were sealed with tape and heat strapping.

The Lockbox Processing Guidelines require that remittances be packaged in cardboard boxes with heat strapping and placed in cloth sleeves that can be sealed with an identification number or tag. Remittances can also be transported in secure, locked metal or plastic boxes.

The guidelines were not fully implemented because lockbox bank staff thought they met packaging requirements agreed to by the IRS by placing all tax information and remittances in cardboard boxes that were taped and heat strapped. As a result, the risk of theft or loss is increased because courier personnel and others could gain access to tax remittances.

### **Controls to ensure that all documents were removed from envelopes were not implemented**

To ensure that all documents are identified and removed from envelopes, the lockbox must either view the envelopes through a light source to determine if any contents remain in the envelope (this process, referred to as “candling,” must be performed twice), or split the envelope on three sides and flatten it. When a check or money order is found, the bank employee should enter the information from the item found on Record of Lockbox Discovered Remittance and Correspondence (Form 9535). An entry should be made every day, each shift, whether items were found or not. The manager should initial the Form 9535 every day for each shift.

At the time of our review, odd sized envelopes (referred to as fats and flats) were candled only once.<sup>4</sup> In addition, results of candling activities were not always documented in the required logs, and managerial reviews were not always documented for entries in these logs.

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<sup>4</sup> Subsequent to our review, the IRS changed its guidelines to require all fats and flats to be opened on three sides and flattened to ensure that all enclosed documents were identified.

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Lockbox management was not aware that they were not meeting candling requirements. Neither internal nor external reviews addressed candling operations.

Insufficient candling increases the risk of taxpayer remittances being lost or destroyed which may result in taxpayer burden and embarrassment to the government. Further, unless a record of discovered remittances is maintained, the IRS and bank management cannot evaluate the effectiveness of manual and machine mail extraction operations.

### **Employee personnel files did not contain all required information**

The lockbox bank maintained temporary employee personnel files without all required information and documents present. Employee files did not contain a current and valid proof of identification with photograph, results of the FBI fingerprint check, and documentation of employee security training and orientation.

The Lockbox Processing Guidelines require the lockbox banks to maintain personal files for employees that contain a signed written waiver to authorize a fingerprint check; the results of the fingerprint check; name, date of birth, social security number, and current, valid proof of identification; hand-writing examples; and photograph. The lockbox must document employees' certification of security procedures and instructions.

Lockbox management had not established procedures to accumulate and maintain required information in specific personnel files. For example, fingerprint results were in one location rather than in each individual folder. Lockbox management thought they were meeting requirements relating to each employee's identification and photograph because they required employees to surrender driver's licenses before receiving temporary identification badges.

Inadequate information and documentation for employees exposes the lockbox to increased risks of unauthorized individuals gaining access to payments and sensitive taxpayer data.

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### **Lockbox management did not receive confirmation that waste material which could have contained sensitive taxpayer information was properly destroyed**

Waste material generated in the processing of tax documents, protected data, or other related documents must be properly destroyed by one of a variety of methods, including shredding. The purpose of destroying the information is to keep it from being disclosed to unauthorized individuals. Generally, the information must be destroyed in the presence of an IRS employee. However, under certain conditions, a sub-contractor may collect and destroy the information. One of the conditions imposed is that the sub-contractor provide a certificate of destruction.

Rather than issuing a separate contract for destruction of IRS waste, lockbox management used the same contractor hired to destroy information for the bank's other operations. The disposal company did issue a certificate of destruction, but the certificate went to the bank's headquarters office, and no confirmation was provided to management of the lockbox facility. This increased the risk of undetected loss or disclosure of sensitive taxpayer information.

### **Recommendations**

The Directors, Customer Account Services, Small Business/Self-Employed and Wage and Investment Divisions should work with the Deputy Chief, Agency-Wide Shared Services to ensure that lockbox management:

1. Develops procedures and implements courier controls as required by Lockbox Processing Guidelines. Subsequent oversight reviews should ensure that procedures and controls have been implemented.
2. Requires air transport services to maintain adequate security at all times over shipments of IRS materials placed in their charge.
3. Adheres to requirements for packaging remittances for transport. The requirements should be met for remittances transported to the bank for deposit as well as

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for deposits shipped to the Submission Processing Center for processing.

4. Performs and documents required reviews of candling practices.
5. Establishes and implements procedures to accumulate and maintain adequate information in each employee's personnel file to readily determine that the employee has met all necessary requirements for access to the lockbox. The review of these files should be included as part of oversight reviews.
6. Receives confirmation that IRS waste material has been destroyed.

Management's Response: Management's response was due on June 27, 2002. As of July 3, 2002, management had not responded to the draft report.

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### **Appendix I**

#### **Detailed Objectives, Scope, and Methodology**

The overall objectives of this review were to:

- Evaluate the physical and internal controls of the new lockbox facility in Dallas, Texas, to determine if taxpayer remittances were adequately safeguarded and taxpayer information was protected from unauthorized disclosure.
- Determine whether the facility provided for employee safety and ensured that operations would continue in the event of a disaster or receipt of hazardous material in the mail.

To accomplish these objectives, we:

- I. Determined the adequacy of employee background screening and controls for personnel security. From approximately 400 files maintained by the temporary hiring agencies and the lockbox, we:
  - A. Reviewed a judgmental sample of 61 temporary employees, bank employees, couriers, cleaning personnel, and others, to ensure that a Federal Bureau of Investigation (FBI) fingerprint check had been completed prior to the date of employment for all individuals that had access to the lockbox processing area or taxpayer information. A judgmental sample was used because statistical projections were deemed unnecessary.
  - B. Reviewed a judgmental sample of 44 lockbox employee personnel folders to determine whether required personnel information was present. Again, a judgmental sample was used because statistical projections were unnecessary.

Samples in A. and B. above were pulled in the following manner:

- We sampled temporary employees by selecting employee folders at random from files maintained by the temporary employment agencies. The temporary employment agencies maintained these folders in locking cabinets.
  - We sampled bank employees by picking names at random from a listing provided by lockbox management. Lockbox management maintained files for these employees in individual folders in locking cabinets.
  - We reviewed all of the couriers included on listings of designated couriers, and sampled vendors by selecting folders at random from files of vendors maintained by the lockbox. Lockbox management maintained files for the couriers and vendors in individual folders in locking cabinets.
- II. Determined whether remittance and taxpayer information was properly received and delivered by an authorized courier service.



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- III. Determined whether the Internal Revenue Service (IRS), the Financial Management Service (FMS), and the lockbox bank had established responsibilities and controls for physical security.
- IV. Determined whether the IRS, the FMS, and the lockbox bank had established responsibilities and controls for data security.
- V. Determined whether adequate controls were in place to provide for employees' safety and ensured that operations continued in the event of disaster or receipt of hazardous or life-threatening material in the mail.

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**Appendix II**

**Major Contributors to This Report**

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**Appendix III**

**Report Distribution List**

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